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INTERNATIONAL TRADE IN FOREST PRODUCTS



Part 1

CANADA'S TRADE LIBERALIZATION POLICIES AND
THEIR IMPLICATIONS FOR THE FOREST-BASED INDUSTRIES

Ontario

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OFFICE OF THE CHIEF ECONOMIST
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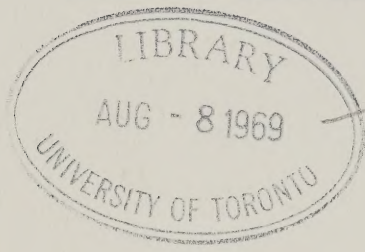
Resources and Transportation Studies Section
Applied Economics Branch

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Department of Economics and Development
December, 1967

IN THE COURT OF CHANCERY
OF THE COUNTY OF MIDDLESEX

1969

AND WHEREAS THE COURT OF CHANCERY OF THE COUNTY OF MIDDLESEX
DOETH NOT HAVE JURISDICTION OVER THE MATTER IN DISPUTE



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PART I

CANADA'S TRADE LIBERALIZATION POLICIES AND THEIR IMPLICATIONS FOR THE FOREST-BASED INDUSTRIES

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Foreword

The complex and diverse aspects of Canada's and other countries' trade policies are currently a major interest for Federal and Provincial governments, industrial associations and other private organizations. In the field of forest products the Federal Government, through the Departments of Industry and Trade and Commerce, has undertaken studies of a number of industries in the light of possible trade developments and tariff changes. Industrial groups such as the Canadian Pulp and Paper Association and the Hardwood Veneer and Plywood Association have presented briefs to the Federal Government on trade policy matters. The Private Planning Association of Canada has studied the impact of trade policies on pulp and paper, furniture and several other industries. In addition, more broadly based studies have been carried out for organizations such as the Economic Council of Canada and the Canadian-American Committee of the Private Planning Associations in Canada and the U.S.A. This report has been developed from the findings of some of these studies and the opinions expressed by industry and government officials and others concerned with the subject of trade policy.

The report is made up of two major divisions: (1) a general outline of the impact of international trade on the forest-based industries and (2) a more detailed analysis of trade in specific forest products. Part I contains a brief review of (a) changing patterns of trade, (b) national trade policy and its objectives, (c) alternative approaches currently under discussion and (d) the probable results which could follow implementation of different trade policies. The Kennedy Round results and the question of bilateral free trade with the U.S.A. are considered. Part II contains analyses of the probable effects of national trade policy changes on (a) the fine paper sector of Ontario's pulp and paper industry and (b) the veneer and plywood industry in Ontario.

As the possible re-shaping of trade patterns resulting from tariff revisions depends on many unknown factors, our general conclusions must be viewed as probabilities rather than as accurate predictions. The available information has been interpreted first in terms of the forest-based industries at the national level and then, wherever possible, further projected to the level of Ontario's forest-based industries and the opportunities and adjustments which may confront them. Due to its relative importance and its major contribution to export trade, the pulp and paper industry receives the greatest attention in the report.

Variations in cost factors between industries and between individual establishments within an industry make the overall assessment of effects of trade and tariff changes highly theoretical. In order to produce more concrete and practical results, cost details of individual firms - both domestic and foreign - would have to be analyzed. The profitability of each product line varies for each manufacturing plant. The data necessary for any such analysis were not available to the author. Each firm must determine its own prospects and problems in the light of changing conditions of trade. Therefore this report, while presenting an analysis of certain economic forces influenced by tariff changes, recognizes that their effect in individual situations may vary according to factors such as company structure, capacity, efficiency, product quality, location and market relationships.

I

INFLUENCE OF CANADIAN AND FOREIGN TRADE POLICIES
ON OUR FOREST-BASED INDUSTRIES

Trends in International Trade

The development of new international trading blocks and the expansion of existing regional associations⁽¹⁾ is under active consideration in a number of our foreign markets. In terms of its impact on Canada's current trade patterns, Britain's application for entry to the European Economic Community (EEC) is presently the most important of these developments. Similar applications of other European Free Trade Association (EFTA) members, and the possibilities for enlarged South American⁽²⁾ and Pacific regional trading associations, are of less immediate concern to Canada although their long-term implications could be serious.

The cumulative effect on Canada's foreign trade of altered trading alignments and changing marketing conditions will be evident in three areas:

1. The decreasing importance of preferential trading terms within the Commonwealth - a growing trend in recent years.⁽³⁾
2. Additional trade barriers to the growing markets of industrial Europe, especially if other countries should come under the common external tariff schedule of the EEC.
3. Continuing dependence on U.S. markets and increasing competition with U.S. producers in both domestic and foreign markets.

These trading developments, coupled with the "Kennedy Round" of GATT negotiations, present Canada with a serious challenge in maintaining its foreign markets, and expanding its export trade in a highly competitive international environment.

- (1) See Appendix I for listing of member countries of the trade associations.
- (2) Current groupings consist of Latin American Free Trade Association (LAFTA) and Central American Common Market (CACM).
- (3) Particularly since the elimination of duties in January 1967 among EFTA member countries.

For 20 years Canada's major foreign market has been the United States. Since 1946, the value of exports to the U.S.A. has annually exceeded the value of exports to our other major foreign outlet, the United Kingdom. In 1966, 60 per cent of our exports, by value, went to the U.S. Britain received only 11 per cent of the exports in that year, with all other countries each receiving lesser amounts (see Table 1). The best short-run opportunity for expanding the market for the products of Canadian industries will continue to lie in the close and populous United States, particularly if Britain is admitted to the EEC and our preferential tariff advantages there are eliminated.

Table 1

GEOGRAPHIC DISTRIBUTION OF CANADA'S DOMESTIC EXPORTS, 1965-66

	1965 Exports		1966 Exports	
	Million \$	Per Cent	Million \$	Per Cent
United States	4,840.5	56.8	6,027.7	59.9
United Kingdom	1,174.3	13.8	1,122.6	11.1
European Common Market	625.8	7.3	636.7	6.3
Commonwealth and Preferential (Except U.K.)	502.3	5.9	547.4	5.4
Japan	316.2	3.7	394.2	3.9
Other Countries	<u>1,066.0</u>	<u>12.5</u>	<u>1,342.2</u>	<u>13.3</u>
Total	8,525.1	100.0	10,070.8	100.0

Source: Exports by Countries, 1966, Dominion Bureau of Statistics.

As shown in Table 2, Canada's export trade rests to a large extent on wheat and crude and fabricated industrial goods from the mineral and forest products industries. A recognized objective for continued economic growth is to increase the level of manufacturing and the "value added" of our exported goods in the processing and secondary manufacturing industries. This objective will not be easy to achieve against competition from other countries, both at home and abroad, even in industries such as forestry where some natural advantages should favour our operations.

Table 2

STRUCTURE OF COMMODITY TRADE EXPORTS, 1965 AND 1966

<u>Major Categories of Commodities</u>	<u>1965</u>		<u>1966</u>	
	<u>Million \$</u>	<u>Per Cent</u>	<u>Million \$</u>	<u>Per Cent</u>
Foodstuffs (Mainly Wheat)	1,709.0	20.0	1,966.6	19.5
Crude Materials (Mainly Minerals)	1,763.7	20.7	1,947.4	19.3
(Logs, Poles, Chips, etc.)	(59.3)	(0.7)	(63.1)	(0.6)
Fabricated Materials (Lumber, Wood Manufactures, Pulp, Papers)	3,728.8	43.7	4,012.1	39.8
End Products (Mainly Motor Vehicles)	(2,033.7)	(23.8)	(2,168.3)	(21.5)
	<u>1,323.7</u>	<u>15.5</u>	<u>2,144.6</u>	<u>21.3</u>
Total Exports	8,525.1	100.0	10,070.8	100.0

Source: Summary of Exports, 1966, Dominion Bureau of Statistics.

The essence of the problem is Canada's industrial structure. Our manufacturing industries are generally higher cost operations, despite lower wage levels, than similar United States industries. This condition is attributed to our tariff protected industrial sector and to a domestic market which is not large enough to support as efficient a scale of operations as in the United States. To compound the problem, foreign tariffs have seriously restricted the access of Canadian producers to large foreign markets. Means to overcome these trading difficulties must be found if Canadian manufacturing is to grow and compete effectively, both at home and abroad. New trade policies must be developed which permit Canada to protect its trading position under the changing conditions of international trade.

Canadian Trade Policy

A basic objective of Canadian trade policy in recent years has been the achievement of greater freedom of trade for the products of our domestic

industries. The major consideration in seeking to reduce trade barriers is to open for our competitive industries larger markets than our domestic economy can provide. The larger markets are expected to result in greater productivity through large-scale production and specialization of our industries. In addition, through reciprocity in response to the reduction in our own protective barriers, Canadian producers and consumers can enjoy access to imported and, in some instances, domestic goods at a lower cost.

Maximum expansion of the manufacturing sector of the economy is the primary objective of our expansionary trade policies. Growth in the manufacturing sector produces the greatest benefits in terms of income and employment generation. In order to achieve the desired expansion, greater access to foreign markets must be obtained for our more highly processed goods and secondary manufactures. Trade policies which foster trade in manufactured papers and fabricated wood products, such as plywood, rather than semi-processed materials such as wood pulp, veneer or rough lumber will be most productive for the Canadian economy. In turn, exports of the semi-processed materials are more rewarding than exports of raw materials such as pulp chips or unmanufactured logs.

Unprocessed roundwood worth one dollar can make some contribution of foreign funds to the nation's balance of payments when exported as such. One dollar's worth of roundwood utilized by our domestic wood-using industries contributes to an output of manufactured goods having more than four times the value of the manufactured logs. As Table 3 illustrates, 726 million dollars worth of logs, bolts and pulpwood were used in 1963 by the major wood-using industries in Canada in the manufacture of goods whose shipments were valued at \$3,123 million. Many of the semi-manufactured and manufactured products are competitive in international markets and have a greater foreign exchange value than the unprocessed roundwood.

Table 3

VALUE OF PRODUCTION AND CONSUMPTION OF ROUNDWOOD
AND SHIPMENTS OF MANUFACTURED GOODS OF THE MAJOR
WOOD-USING INDUSTRIES IN 1963

<u>Sources and Users of Roundwood*</u>	<u>Value of Roundwood* Used</u>	<u>Average Annual Value of Production 1961-1963 (Millions of Dollars)</u>	<u>Value of Shipments of Manufactured Goods and Roundwood*</u>
Primary Forest Production		825.5	
Imports			20.1
Exports			32.3
<u>Wood-Using Industries</u>			
<u>Total</u>	<u>726.4</u>		<u>3,123.6</u>
Pulp and Paper Mills	371.1		1,793.2
Sawmills and Planing Mills	281.1(e)		782.6
Veneer and Plywood Mills	67.3		190.9
Other Industries**	6.9		356.9

(e) estimated

* Roundwood includes logs, bolts and pulpwood.

** Other industries include sash, door and planing mills, hardwood flooring industry, wooden box factories and miscellaneous wood industries.

Source: Dominion Bureau of Statistics.

It is recognized that growth in the exports of more highly manufactured goods would be in part at the expense of the semi-processed and raw materials trade. The Canadian Government has been urged in the past to resist efforts by other countries to obtain long-term supplies of Canadian roundwood. If the wood equivalent of a ton of newsprint is sold for \$35.00 or \$40.00 in the form of pulpwood to supply uneconomical paper producers in Europe, a chance to sell it in the future for \$130 a ton or more as a manufactured product will be lost.

Canadian export statistics for 1966 indicate that the equivalent of two million tons of newsprint was exported in the form of pulpwood and chips with

a value of \$41,000,000 - the equivalent newsprint value would have been in the neighbourhood of \$260,000,000. The extension of the above argument to exports of papers worth \$200 and more a ton, as opposed to semi-processed pulps sold at \$90 for the equivalent of a ton of paper, is equally valid.

In order to gain more liberal entry to foreign markets for the manufactured products of our forest-based industries, Canada will have to offer reciprocal reductions in its own protective tariffs. These reductions can least painfully be made where our natural advantages and our export potential are greatest.* These least sensitive areas include industrial products such as our forest products.

Canadian Tariffs and Trade in Forest Products

The tariff-protected sector of our forest-based industries includes the producers of the various types of paper - except newsprint and periodical papers - the paper converting industries and all other secondary manufacturers in the paper trades and all wood product manufacturers with commodities processed beyond the stage of dressed lumber. Other forest products - logs, pulp chips, wood pulp and newsprint - already enter Canada, U.S.A. and the United Kingdom free of duty. (All forest products from Canada enter the U.K. free of duty under the Commonwealth preference system.)

Imports of forest products into Canada in 1966 were valued at slightly more than \$169 million, a decline of almost \$100 million from the corresponding value of imports in 1960. The 1966 imports equalled only $7\frac{1}{2}$ per cent of the total value of Canadian forest products exports in the same year.

*Other reductions will also have to be made. The Minister of Finance stated in 1966 at the International Conference on Canada and the Atlantic Community, "I would not want to leave the impression that when I think of industrial sectors in which the major countries should move toward free trade I am referring only to those in which Canada appears to have a clear competitive advantage over other countries." The Minister mentioned pulp and paper products and mineral products as commodities in which Canada holds a clear advantage.

Approximately two-thirds of the imports were dutiable commodities, the largest categories being \$62 million worth of papers and paperboards and \$35 million worth of veneer, plywood and other fabricated wood materials. As shown in Table 4, the majority of the imported commodities came from the U.S.A. The only exception was in the veneer and plywood category where 56 per cent of the 1966 imports came from Japan and Taiwan.

Table 4

CANADIAN IMPORTS OF FOREST PRODUCTS, 1966

<u>Commodity</u>	<u>Value</u> <u>(\$'000)</u>	<u>Imports</u> <u>From U.S.A.</u> <u>(%)</u>
Crude Wood Materials	24,067	99.2
Lumber	38,335	85.7
Veneer, Plywood and Wood Building Boards	23,172	34.0
Other Wood Fabricated Materials	12,539	87.1
Wood Pulp and Similar Pulp	8,904	82.8
Paper and Paperboard	<u>62,035</u>	<u>94.6</u>
Total	169,052	83.8

Source: Dominion Bureau of Statistics.

Canadian exports of forest products were valued at \$2,244 million in 1966, an increase of 40 per cent over the comparable figure for 1960 (see Table 5). In 1964, the value of exports, \$2,012 million, equalled four-tenths of the total value of shipments of manufactured goods and primary forest products from the forest-based industries. The Ontario industries accounted for more than one-quarter of the total value of shipments - as illustrated in Table 6.

Table 5

CANADIAN EXPORTS OF FOREST PRODUCTS, 1960 AND 1966

<u>Export Category and Commodity</u>	<u>Value of Exports</u>		Percentage Change
	<u>1960</u>	<u>1966</u>	1960 to 1966
	(Millions of Dollars)		<u>(In Constant Dollars)(1)</u>
			%
<u>Crude Materials</u>			
Pulpwood	25.8	32.6	+13.6
Pulp Chips	5.3	8.4	+42.4
Other Unmanufactured Wood	56.5	(2)	
Other Crude Wood Materials	(2)	22.2	+ 6.2*
<u>Fabricated Materials</u>			
Lumber and Other Sawmill Products	367.3	511.7	+23.7
Other Manufactured Wood	8.0	(2)	
Veneer	(2)	31.8	+52.9*
Plywood	(2)	41.5	+126.8*
Other Wood Fabricated Materials	(2)	7.4	+ 2.8*
Wood Pulp	325.1	520.1	+50.4
Newsprint Paper	759.6	972.1	+13.0
Book and Writing Paper	12.2	32.9	+141.9
Paperboard	12.2	30.9	+153.3
Wrapping Paper	5.4	8.2	+43.9
Other Papers	5.2	14.9	+170.9
Paper Products	<u>4.1</u>	<u>9.0</u>	<u>+104.5</u>
Total	1,586.8	2,243.7	+26.9

*Percentage change from 1961 to 1966.

- (1) Based on changes in Industry Selling Price Indices and General Wholesale Index for selected commodities.
 (2) No comparable figures available due to export commodity classification revisions in 1961.

Source: Dominion Bureau of Statistics and Reference Tables
 (Canadian Pulp and Paper Association).

Table 6

VALUE OF SHIPMENTS OF GOODS MANUFACTURED
BY THE FOREST-BASED INDUSTRIES, 1964

	<u>Value of Shipments</u>		<u>Ontario</u>
	<u>Canada</u> (Millions of Dollars)	<u>Ontario</u>	<u>%</u>
Wood Industries	1,395.9	221.0	15.8
Paper and Allied Industries	<u>2,707.3</u>	<u>950.2</u>	<u>35.1</u>
Primary Forestry Production	4,103.2	1,171.2	28.5
	<u>986.9(e)</u>	<u>165.0(e)</u>	<u>16.7</u>
	5,090.1	1,336.2	26.4

(e) estimate

Source: Dominion Bureau of Statistics.

Shipments of those commodities which enter other countries duty-free currently constitute the great bulk of our trade in forest products. In 1966, approximately two-thirds of all forest products exported from Canada were logs and bolts, pulp chips, wood pulp, newsprint and other duty-free commodities sent to the U.S.A. and Great Britain.

In 1965, the value of Canadian forest products exported to the U.S.A., was \$1,581 million, or three-quarters of the value of our forest products exports to all countries. Exports from Ontario accounted for \$359 million, or 23 per cent of the total value of exports of these products to the U.S.A. Table 7 shows the value of forest products which were manufactured in Ontario and exported to the U.S.A. Almost nine-tenths of Ontario's exports are made up of commodities entering the U.S. duty-free.

Table 7

ONTARIO AND CANADIAN EXPORTS OF
FOREST PRODUCTS TO U.S.A. IN 1965

<u>Commodity Group</u>	<u>Ontario Exports</u> (Thousands of Dollars)	<u>Total Canadian Exports</u> (Thousands of Dollars)	<u>Ontario Percentage</u> %
Crude Wood Materials	9,326.7	30,358.5	30.7
Sawmill Products	23,119.0	377,570.8	6.1
Veneer and Plywood	15,344.8	35,386.1	43.4
Other Fabricated Wood Materials	1,673.6	4,408.7	38.0
Wood Pulp	93,709.8	371,427.9	25.2
Newsprint and Other Printing Papers	209,462.4	748,432.2	28.0
Other Papers	<u>6,015.5</u>	<u>13,317.8</u>	<u>45.2</u>
Total	358,651.8	1,580,902.0	22.7

Source: Dominion Bureau of Statistics.

A feature common to many Canadian firms in the forest-based industries sector is the production by the same plant of both tariff-protected commodities for our domestic market (i.e. fine papers) and export-oriented commodities such as wood pulp or newsprint. This dichotomy places the firm in the position of favouring the extension of free trade or lower tariffs in foreign countries for pulp and newsprint, while at the same time, pressing for high protective tariffs for Canada on the firm's other types of papers and paper products. However, the best long run opportunities for our resource-based firms will occur as a result of more liberal trading conditions among the industrial nations, including Canada. A national trade policy which will lower the tariff on our protected commodities may be necessary in order to produce reciprocal tariff reductions for our most competitive forest products in foreign markets.

II

ALTERNATIVE POLICIES FOR TRADE LIBERALIZATION

The following sections outline some of the types of trade agreements and other government policies which may be put forward by Canada for the purpose of improving export opportunities for our forest products.

Free Trade

The Federal Government has indicated that it intends to seek free trade with as many countries as possible for many manufactured commodities such as forest products. In order to achieve world-wide free trade in Canadian forest products, national policies are needed which will foster the elimination of both tariff and non-tariff barriers to trade. While tariff rates on many commodities will be reduced to relatively low levels as a result of the Kennedy Round, the major non-tariff barriers will remain in effect. Complete free trade, if it is to be ever achieved, will have to be developed in "easy stages" through partial reduction and gradual elimination of all barriers.

The Canadian Government has at its disposal a number of policies and tactics with which liberalization of trade might be achieved. In the broadest terms, the policy alternatives consist of either reducing or eliminating our own protective tariffs and non-tariff barriers in order to persuade our trading partners to reciprocate. The choice of trade policies to be followed by the Federal Government will depend on two factors: the domestic effects of any policy, and other countries' responses to our trade policy. Analysis in this report of alternative trade policies is limited, in the main, to their effects on the domestic environment. The international aspects - the possible response of other countries to Canada's trade liberalization proposals - require a separate study outside the scope of this report.

Tariff Reductions

A basic step in any policy for trade liberalization is the reduction of tariffs against imported goods. The Canadian Government has already taken this step in the Kennedy Round. In the past, reductions in Canada's protective tariffs have generally been opposed by our domestic manufacturers. The Canadian-American Committee of the Private Planning Associations of U.S. and Canada, in its support for an Atlantic free trade area approach, in 1966 offered the following criticism of the GATT negotiations for multi-lateral tariff reductions:

"Partial reductions in other nation's tariffs do no more than decrease the competitive disadvantage of Canadian goods moving abroad. On the other hand, the corresponding acts in Canadian protection facilitate penetration of the domestic market by already lower priced foreign goods. There appears insufficient incentive in such partial tariff cuts for a full restructuring of Canadian industry."*

Some substantial tariff reductions affecting the rates of duty on most forest products have been agreed to by Canada in the Kennedy Round negotiations. The details of these reductions in the light of their probable effects on trade are given in Chapter V of this report.

Non-Tariff Barriers

Trade liberalization will require the relaxation of non-tariff as well as tariff barriers. In the view of many Canadian exporters, other countries' non-tariff barriers are a serious problem. These barriers are "cumbersome, costly and obscure and act as a brake on trade - very often they counteract the effects of even very far reaching tariff reductions"** The subject of non-tariff barriers is highly complex. The more "simple" and negotiable barriers include quota systems,

* "A New Trade Strategy for Canada and the U.S.", Atlantic Community Quarterly, Summer, 1966.

** "Non-tariff Barriers to Trade and Competitive Disadvantages in Foreign Markets", Canadian Electrical Manufacturers Association, 1967.

automatic anti-dumping laws, discriminatory valuation of imports and documentation procedures among others. The more complex barriers include discriminatory standards of quality, discriminatory shipping rates and regulations and other provisions such as governmental purchasing preferences which favour domestic rather than foreign services and products. As with other aspects of trade, any demand for the elimination of non-tariff barriers must be supported by reciprocal relaxation of Canada's own barriers. The Federal Government recently made a commitment to GATT to establish new, less-restrictive anti-dumping regulations covering imports to Canada. Other non-tariff trade barriers may also have to be relaxed in order to win further advantages in foreign markets for Canadian exports.

Area and Commodity Trade Agreements

Policies for free trade can be separated into two categories: (1) the area or geographic approach - regional and world-wide trade agreements, and (2) the commodity approach - sectorial and "blanket" trade agreements. Regional agreements can cover multilateral and bilateral policies for trade liberalization, as within an Atlantic association of countries, or bilaterally with the U.S.A. alone. Within the geographic framework, alternatives exist in the various types of commodity agreements. The alternatives include general or blanket trade agreements covering all commodities, or more limited agreements for trade liberalization covering fewer commodities. The limited commodity agreement may be established on a sectorial basis to cover the products of one industry.

Prime Minister Pearson, in an address* to the International Chamber of Commerce Congress in May, 1967, stated:

*"The Next Steps in Trade Liberalization", Atlantic Community Quarterly, Summer, 1967.

"Now, more and more, trade discussions have to deal with a variety of new and complicated barriers..... There is a growing appreciation that certain whole sectors or industries must be approached on a broad international front..... By dealing with these industries as a whole, it may be possible to negotiate balanced bargains covering both tariff and non-tariff barriers."

The description of the type of industry to which he was referring is certainly appropriate to some sectors of the forest-based industries - characterized by high capital investment, advanced technology, large-scale production and widely dispersed international operations.

One limited form of free trade for Canadian commodities may be achieved through the development of regional trade agreements. A regional agreement might include at least the U.S. and the EFTA countries as the nucleus of a free trade area. Some type of Atlantic Free Trade Area has been advocated in recent years. The Federal Government has stated its disinterest with restricted membership agreements as they would tend to act as additional barriers to expanding world-wide trade with countries outside the regional bloc. In 1966, Prime Minister Pearson stated that:

"Discriminatory, inward-looking regional groupings ... are no answer to the problems of the world today. Whether formed on a European or North American or even an Atlantic basis. Unless such groups are so organized as to look outward, as to lead to wider arrangements they can be a step backward rather than forward."*

As an example, the EEC will adopt common tariffs against goods from all non-member countries on July 1, 1968. The external tariff system of the EEC is threatening to adversely affect imports to the EEC member countries whose own tariffs were initially lower than the forthcoming common tariff rates. GATT membership, on the other hand, is available to any country and the results of GATT negotiations are available to all member countries on the Most Favoured Nation basis. With the possibility of increased regional barriers for Canada's

*From an address by Prime Minister Pearson to the International Conference on Canada and The Atlantic Economic Community, November, 1966.

exports to Europe, the feasibility of a North Atlantic Free Trade area is being given serious study by private bodies such as the Private Planning Association of Canada.

Bilateral Arrangements

A more restricted type of regional agreement would be a bilateral trade agreement between Canada and the U.S.A. In recent years the possibilities for various free trade arrangements between Canada and the U.S. have become a popular subject for discussion and study. Besides the final extreme of complete union and absorption by the U.S.A., two other arrangements are under scrutiny; first, complete, or almost complete, free trade and second, limited free trade in selected commodities only, as in a sectorial agreement.

The elimination of tariff and other protective barriers could be negotiated under three different arrangements; (1) a free trade area system, (2) a customs union, and (3) a common market. In each of these systems protective trade restrictions between the member countries - Canada and the U.S. - would be eliminated on substantially all commodities.

The systems differ primarily in their degree of mutual action on trade relations with non-member countries. Each offers the elimination of trade restrictions among the member countries. In a "free trade area" arrangement each of the member countries can maintain their own external tariffs with outside countries. The European Free Trade Association is such an arrangement. In a "customs union" the member countries would establish a common external tariff against outside countries. The "common market" arrangement, as exemplified by the European Economic Community, represents a much greater degree of integration among the member countries both in trade policies and in other spheres. Some

type of free trade area agreement appears to be the most acceptable of the three systems.

The forest-based industries have favoured a free trade arrangement which would also encompass the European countries rather than an agreement with the United States alone. In the larger grouping, our producers would not have to face only the competition of U.S. producers who have specialized to a much greater degree, and whose plant and machinery is already of optimum size. The Canadian manufacturers would also compete with the generally less efficient European manufacturers. The European producers, particularly in the U.K. and EEC countries, must rely to an increasing extent on imported raw materials in order to meet the growing demands of their market. There has been strong European opposition in the past to tariff reductions on pulp and papers, particularly from the EEC, because of their fear of North American competition.

In political terms, Canada would appear to have more independence and freedom in a trading group such as an Atlantic or Hemispheric Association, than in any type of association with the United States alone. An American Free Trade area which would also include Caribbean and Central American countries has also been proposed. Due to the relatively undeveloped state of the other countries, it would be very little different from a bilateral agreement with only the U.S.A. There is vigorous public opposition to any general free trade agreement with the U.S. As Department of Industry Minister Drury recently stated, "A North American free trade area is only one of various ways toward freer trade and, in my opinion, not necessarily the most suitable for Canada, or the one most likely to produce the best maximum results."

A Canada-U.S. arrangement in respect of which there could be more public support is that of free trade in particular products only. Limited bilateral free

trade agreements such as the auto pact are more acceptable to Canada than the more complete forms of economic integration as in a common market, because the degree of independence which must be forfeited is in theory, greatly lessened. There is a possibility that other GATT members might react unfavourably toward further bilateral agreements for individual industries beyond the current Canadian-United States auto trade agreement. In addition, the position of the United States government on further bilateral agreements is uncertain.

A sectorial free trade agreement could cover the products of the forest-based industries. There is already free trade between the two countries in many raw and semi-processed forest products - roundwood, pulp chips, semi-finished lumber, wood pulp, newsprint and waste papers.

The forest industries' criticisms of a limited, single-industry free trade approach have centred on the fact that inputs for the manufacturers would, in many instances, still be dutiable. This would be the case for imported United States mill machinery. The industry holds that such a disadvantage would make it difficult for our producers to achieve competitive production costs.

It has also been suggested that a single-industry approach would not provide enough incentive to the Federal Government to alter their anti-combines legislation. Some manufacturers believe that mergers and industry-wide planning will be necessary in order to be able to deal successfully with a lessening of protection here and in the U.S. Without some relaxation of the current anti-combines legislation in Canada, such activities could be illegal.

A brief* from the Canadian Electrical Manufacturers Association to the Economic Council of Canada urges more flexible anti-combines legislation in order

*Submission to the Economic Council of Canada on "Certain Important Aspects of the Responsibilities of the Registrar General of Canada" from the Canadian Electrical Manufacturers Association, July, 1967.

to permit those manufacturers facing reduced tariff protection to improve their competitive strength. The electrical manufacturers contend that changes in world economic conditions, including the growth of the European Economic Community and tariff reductions under the Kennedy Round, could be relied on to increase and preserve competition in the Canadian domestic market.

The various policy alternatives which are open to the government - reductions in tariffs and other barriers and limited free trade agreements - are not mutually exclusive. Rather they can each be considered to be progressive stages toward a distant objective of complete and universal free trade in forest products. In the immediate future some tariffs will be reduced by Canada and other GATT members. After the implementation of the current round of reductions, opportunities and necessities may well force Canada to consider further steps in trade liberalization. Subsequent steps could include further tariff reductions or other, more liberal, trade policies or alternatively, the unwelcome prospect of reciprocal trade restrictions and increased barriers. It appears likely that progress toward free trade in Canadian forest products will occur as a result of further reductions in tariffs and non-tariff barriers through sectorial free trade agreements on a regional or wider, multi-national basis. A recent, sectorial liberalization program which has significance for future Canadian trade policies is the Canada-U.S. auto pact. The following chapter outlines the possibilities for a similar sectorial agreement to permit Canada-U.S. free trade in forest products.

III

FREE TRADE IN FOREST PRODUCTS BETWEEN CANADA AND THE U.S.A.

Canada's Forest-Based Industries and The Auto Pact

There are a number of obvious differences between the auto industry and the forest-based industries. These conditions make it difficult to appraise the applicability of a Canadian-U.S. trade agreement strictly patterned on the auto pact. In the words of the Federal Minister of Industry "the automotive program was devised to meet a rather unique set of circumstances and, as such, is not directly applicable to other industries".*

The Canadian auto industry is comprised of a few large firms, subsidiaries of U.S. parent companies. Their products are similar and have been advertised jointly in the U.S. and Canada for many years. The Canadian industry supports a number of small domestic industrial suppliers who are highly susceptible to the repercussions of the trade agreement.

The forest-based industries are a group of separate and distinct industries whose common feature is their use of forest products as raw materials. The industries which are considered in this section are those primary and secondary manufacturers whose products are industrial goods manufactured from raw or semi-processed forest products. The pulp and paper industry is the major component of the group in terms of value of shipments, although the wood industries - sawmills, veneer and plywood mills, sash, door and planing mills, casket makers and others - represent a much greater number of individual establishments.

In order to realistically judge the possibilities for a free trade agreement for our forest-based industries each member in the group must be

*"Canadian Commercial Policy on Perspective": An address by C. M. Drury, Minister of Industry, to World Trade Conference, 96th Annual Meeting, C.M.A., Toronto, May 29, 1967.

considered individually. Even within one industry, product groups must be reviewed separately. Thus the fine, wrapping, tissue categories within the pulp and paper industry are distinct units with different potentials for free trade.

It was recognized by the Federal Government when the auto pact was being developed that the elimination of the U.S. tariff would not be sufficient to remove the institutional impediments to the automotive trade. These impediments, resulting from U.S. ownership, could also limit domestic production and exports. In order to overcome these barriers, Canadian auto manufacturers were committed to substantially expand their production and maintain the Canadian content of their production over the period of the initial agreement to 1968. The current agreement is thus, in effect, a conditional free trade agreement.

Because of the different structure of our forest-based industries, impediments related directly to U.S. ownership of Canadian firms are less significant than in the auto industry. A considerable number of our Canadian firms in the forest-based industries group are not controlled by U.S. corporations, even in the pulp and paper sector where U.S. participation and ownership of Canadian production facilities is high. As an unavoidable corollary, conditional clauses which would guarantee for our firms a share of the growth of the U.S. - or Canadian - market would certainly not be offered by the U.S. firms in a forest-product free trade pact. Unfortunately, there are some institutional barriers in the U.S. marketing system which cause formidable difficulties for the independent Canadian pulp and paper producers. There are only a few independent or open marketing outlets serving the U.S. consumers of papers. Most of the U.S. outlets and converters are producer-controlled and are tied to one company's products. The result is that Canadian mills which are not affiliated with U.S. corporations have difficulty obtaining large-scale marketing outlets and customers among the paper converters in the U.S.A.

The forest-based industries consist of a large number of establishments producing a great variety of products. The major industries are pulp and paper mills, sawmills, paper box and bag manufacturers and veneer and plywood manufacturers. The lesser members include miscellaneous paper converters, hardwood flooring, cooperage, wood-turning and woodenware establishments.

As noted previously, some of the firms are affiliated with U.S. companies or otherwise financed by foreign funds, particularly in the pulp and paper industry. The majority of the firms in the other industries are still small, independent Canadian operations. While there were 131 primary pulp and paper establishments in Canada in 1964, there were also more than 5,000 individual firms in the wood industries group.

In the last decade there has been a trend toward consolidation and enlargement through integration within the forest-based industries. The smaller pulp and paper mills and sawmills are often marginal operations incapable of modern high volume, high quality production. The future prospects for such firms are poor regardless of possible developments in Canadian and United States trade agreements. In the last two years, six small groundwood pulp mills located in Eastern Canada have had to heavily curtail production or shut down entirely. In Ontario, Domtar Ltd., has announced that it will close its St. Catharines sulphite pulp mill early in 1968.*

The major categories of manufactured products from the forest-based industries, from paper to plywood, are each generally unique in production methods, costs and end uses. As opposed to autos, the commodities are low unit value items, mass produced in numerous different grades, dimensions and species for a variety of firms for further manufacturing into other industrial or consumer goods. The

*Financial Post, September 2, 1967 and July 15, 1967.

consumer market does not provide a large outlet for the products. A similar industrial structure exists in the United States where mergers, consolidations and integration have been even more prominent than in Canada.

Results of a Free Trade Agreement

Some continental reorganization of production facilities based on raw material supplies and markets could be expected to result from a free trade agreement. In the forest-based industries, as elsewhere, the least efficient firms might not withstand new foreign competition. The larger, already more efficient producers in the United States could replace some of our smaller, less efficient, producers. This has been evident in the domestic auto parts industry following the trade agreement. However, the converse would also be true with Canadian firms dominating in some of the sectors. Under duty free entry, Canadian newsprint manufacturers have held a strong position in the U.S. market for many years. Our producers should still continue to do well in the future, despite the rapid growth of a domestic industry in the southern states. It is the overall net result of the relative efficiencies of the various Canadian and American producers by which a free trade agreement in forest products must be judged.

The industry has stated that sales taxes and duties on goods and machinery purchases will leave our producers at a disadvantage compared to U.S. competitors, as most of the manufacturing machinery is imported. The new Canadian tariff rates on machinery will average out to nine per cent. This average level will be derived from two different rates: (1) free entry for machines not available from Canadian sources and, (2) a 15 per cent tariff on machines which are or could be manufactured here. The rates will take effect in only one stage in January, 1968.

It is interesting to note that the United States machinery manufacturers, in 1966, unsuccessfully urged that their government should raise tariffs on foreign

pulp and paper making machinery (European) to their previous level of 25 per cent from the current level of $7\frac{1}{2}$ per cent. New Kennedy Round rates will range from $3\frac{1}{2}$ to five per cent for most machinery entering United States, still considerably below the new Canadian rate.

In the auto parts industry, and despite lower average wage rates in the Canadian industry and the discount on the Canadian dollar, average costs for our manufacturers are estimated to be five to 15 per cent higher than in the United States.* In more general terms, it is believed that, "many Canadian industries have higher production costs than comparable U.S. enterprises, even though manufacturing wages average 17 per cent below U.S. rates".**

In the forest-based industries there are, according to spokesmen for some sectors of the industries, similar cost disadvantages, particularly for smaller producers. The disadvantage is less severe due to lower raw material costs - wood and water. The gap in productivity between Canada and U.S.A. is much smaller - if not non-existent - in the forestry sector than in other areas of manufacturing. Any remaining disadvantage could probably be effectively eliminated for some of our operations through large scale, more efficient manufacturing processes.*** The large-scale, efficient operations could develop from the impetus of a much larger continental market.

Under a free trade pact it is possible that raw materials (logs) would move in much greater volume to the most efficient neighbouring U.S. manufacturers for processing - to the extent that transportation costs would make this traffic economical. However, the exporting of logs is restricted by most provinces,

*"The Automotive Agreement" by Paul and R. J. Wonnacott, Canadian Journal of Economics and Political Science, May, 1967.

**"Canada-U.S. Trade Relations", from World Business, March, 1967.

***See Chapter 6, Scale and Specialization in Manufacturing, from the Fourth Annual Review, Economic Council of Canada, September, 1967.

including Ontario. Similarly, interprovincial shipments of these raw materials to our most efficient mills might also increase, unless restricted by provincial authorities.

Ontario's legislation governing the export of logs is spelled out in the Crown Timber Act, Section 14,* which states:

"14. - (1) Every licence is subject to the condition that all timber cut thereunder, except timber that is used in Canada in an unmanufactured state for fuel, building or other purposes, shall, except as provided in subsection 2, be manufactured in Canada into ties, poles, pit props, lumber, veneer or such like products or into pulp.

(1a) For the purpose of subsection 1, chips produced as a by-product of the manufacture of lumber shall be deemed to be manufactured into lumber.

(2) The Lieutenant Governor in Council, after giving thirty days notice of his intention so to do by publication in The Ontario Gazette, may suspend the operation of subsection 1 as to any kind or class of timber that he designates for such period as he deems proper and as to any area that he defines.

The restriction applies only to timber cut from public lands or which is otherwise the property of the Crown and for which a cutting licence has been issued. No restriction is placed on the exporting of timber cut from patented lands in the province. The only requirement is that a statutory declaration** must be made which states that the forest products to be exported were cut from patented lands. Similar Quebec legislation concerning Crown timber covers the movement of logs across the provincial boundaries as well as across the Canadian border.

As a result of the increase in domestic production of cars and parts following the auto pact, the suppliers of raw materials and industrial goods for the auto industry have an expanded market. If the Canadian forest-based industries' production were increased substantially, some secondary expansion

*Section 14, The Crown Timber Act, Revised Statutes of Ontario, 1960, Chapter 83 as amended by 1961-62, Chapter 27.

**Section 15, The Crown Timber Act. op. cit.

would also occur in the market for supporting services and equipment. However, the impact of increased production would be greatest on the immediate supply of standing timber and the actual timber harvesting operations. Increases in the scale of logging operations could generate some increase in the demand for woods labour - which is already becoming relatively scarce - and modern mechanized logging equipment. Rapid increases in timber consumption could pose future problems for the forest-based industries. If any great expansion of industrial production and raw material consumption occurs without similar increases in current expenditures for future timber production and forest land management, eventual shortages of material would be a possibility.

Another industry operating under a free trade agreement is the farm implement industry. For 23 years North American free trade in farm implements has been in effect. As contrasted to the conditional trade agreement of the auto industry, there are no production guarantees or share of market conditions incorporated in the agreement.

Concern is currently being felt as the volume of imports of farm implements is increasing more rapidly than our domestic producers' share of the market. In 1966, imports of farm implements were valued at approximately $2\frac{1}{2}$ times the value of exports.

Before any further steps are taken toward other Canadian/U.S. industrial free trade agreements it will be useful to appraise the effects of the tariff reductions resulting from the Kennedy Round. The large reductions in some U.S. and Canadian tariffs on forest products may alter the prospects for the forest-based industries under a bilateral free trade pact for the Canadian industry.

IV

THE KENNEDY ROUND

Four years of negotiations and bargaining on tariff rates under the General Agreement on Tariffs and Trade (GATT)* came to a close in 1967. The results will have great significance for our economy.

The objective of the "Kennedy Round" negotiations was to reduce all types of trade barriers between the 84 member countries, including the EEC members, U.S.A., England, Japan and Canada.** In general, tariff reductions were to be achieved through equal across-the-board tariff cuts, with a minimum of exceptions placed on a country's reserved commodities list. The target for negotiations was a 50 per cent reduction in tariffs, the maximum level open to U.S. negotiators under their current trade expansion act (except for present tariff rates of five per cent or less which could be eliminated).

Some modification to an equal across-the-board approach was found necessary for two reasons: (a) due to significant disparities in tariff levels between some members, and (b) in order to accommodate countries which are largely dependent on primary products, when comparable benefits cannot be gained through linear reductions.

Some sectors of the Canadian forestry industry have been opposed to a linear reduction of tariffs on an equal percentage basis between Canada and the United States. Pulp and paper producers feel that an increase in American paper exports to Canada is much easier to achieve than an expansion of Canadian exports in protected grades to the United States. The industry fears that an equal percentage cut in tariffs would not produce a balance of advantage between the two

* See Appendix for statement of GATT principles.

**See Appendix for complete listing of participating countries.

countries. This is attributed to factors related to the basic disparity in the countries' cost-price structures. Lower unit costs and prices in the U.S.A. are the result of their more efficient, large-scale production facilities, resulting, in turn, from their much larger domestic market. The American industries have historically required (or received) less protection. Current United States tariff rates are often considerably below our rates. On most paper commodities their tariffs range from five to 18 per cent, compared to Canadian rates of 20 to $22\frac{1}{2}$ per cent. Thus an equal percentage reduction in tariffs would represent a larger absolute reduction in Canadian than in American domestic prices.

It is significant to note that the converse of this argument has been used, apparently effectively, by the EEC. The EEC took the position in the recent negotiations that their tariff reductions must be less than the American reduction of 50 per cent because the United States tariffs are so much higher than the EEC rates.

The U.S.A., EEC, Britain, Japan, Sweden, Switzerland, Denmark, Norway and Austria agreed to participate on the basis of equal linear cuts. Canada, Australia, New Zealand, South Africa and some other countries participated on the basis of reducing their tariffs by varying amounts which would represent, in total, an equivalent reduction.

It has been estimated that the agreements which have been reached represent a reduction in tariffs amounting to one-third of current rates. The overall average reduction of one-third has resulted from three factors: 1) exclusion from negotiations of a small number of products (including many agricultural commodities) whose tariff rates will be unchanged; 2) a minor reduction of the EEC tariff rates which are substantially below those of the U.S., Great Britain, and Canada; and 3) reductions of up to 50 per cent of the duties on all other items.

This means that a large number of industrial tariffs are to be cut by one-third to one-half.

The following statement was issued by the Director-General of GATT, announcing successful conclusion of the Kennedy Round negotiations.

"In the industrial field, the negotiations have been based on a working hypothesis of a linear tariff reduction of 50 per cent by major industrialized countries, and have resulted in important tariff cuts over a very wide range of industrial products. In many areas reductions of 50 per cent have been agreed."

A gradual reduction in tariffs by stages over the next four years will begin in January, 1968.

The two most significant factors for Canada from the coming tariff changes are: 1) increased accessibility to United States, EEC and other large markets for our manufactured and industrial goods, and 2) increased foreign competition which our manufacturing sectors will face with the reduction in our protective tariffs.

A study* published for the Economic Council of Canada states:

"A substantial reduction of these (Canadian) tariffs on a broad range of products could bring important new forces into play in the Canadian economy which could fundamentally alter the current competitive situation, provide many existing industries with an opportunity to accelerate or redirect their operations into more profitable channels, and lead to the establishment of new lines of production in Canada. In particular the reduction of tariffs could provide Canadian industry with opportunities to reduce uneconomical diversification resulting from the need to offer a wide variety of products to a relatively small number of consumers and to create large and more specialized production units serving both the domestic and export markets. Accompanying reductions in Canadian tariffs could also tend to provide shifts towards more specialized and competitive indigenous production."

It is also important to recognize that our domestic manufacturers are sometimes uninterested in exporting to distant markets if their domestic market can provide, more easily, equal or even lower profits. Many producers will accept

*Staff Study No. 7, Canada and World Trade, by M. G. Clark, for the Economic Council of Canada, December, 1964.

a lower level of certain profits rather than attempt to penetrate foreign markets because of the greater risks and difficulties inherent in competing in those markets. The lack of knowledge of foreign markets is an additional drawback for many small domestic firms. However, both sides of the "domestic versus export markets" question will be altered for our manufacturers when competition at home and opportunities abroad are both increased.

The greatest impact of the tariff reductions will be felt in trade with our largest consumer, supplier and sometimes competitor, the United States. Across-the-border trade is expected to increase greatly. In general terms, it seems that the more highly processed stages of our industrial goods - forest and mineral products - and manufactures from them should have the greatest opportunity for expansion. A statement from the 1957 studies of the Royal Commission on Canada's Economic Prospects indicates that "given access to the American market Canada would have a substantial advantage in the fabrication of a wide variety of products, especially those resting on indigenous power resources and raw materials. A few examples come readily to mind: paper and wood products; petro-chemicals and other chemical products, refined metals and minerals and certain of their manufactured products. A detailed examination would no doubt reveal others."

Our forest-based industries will face the need for some major adjustments to meet new demands and stronger competition. In terms of our own tariffs, reductions on rates imposed on imported goods and machinery used in manufacturing will improve the competitive position of our industries. The Canadian industry feels that any concessions made on the protected commodities should be accompanied by concessions made on products used by firms engaged in manufacturing papers, plywood, particle board etc. To the extent that costs of materials and capital equipment used by the industry are reduced by tariff concessions it would be an offset - although a minor one - to the costs of concessions given on protected commodities.

Canadian domestic prices of many papers and manufactured wood products are generally somewhat higher than American domestic prices. A reduction of 50 per cent in our current protective tariffs on some forest products will produce a reduction in domestic prices to the extent that landed prices (including duty) will decrease on competing imported items from the U.S.A. If, as outlined on page 25, a comparative-cost disadvantage in the neighbourhood of 15 per cent did exist for Canadian forestry producers, the current tariff of $22\frac{1}{2}$ per cent would provide a cushion of at least $7\frac{1}{2}$ per cent for the average firm in the domestic market over competing United States products. A reduction of anything more than one-third ($7\frac{1}{2}$ per cent) in the tariff rate would seem to place our manufacturers in a non-competitive situation in terms of price within their own domestic markets.

However, production costs are only one element contributing to the final market price of a commodity and the effective level of protection for manufactured goods may be considerably higher than the nominal protection represented by the actual tariff rate.* In addition, the Canadian forest industries do not face a 15 per cent cost disadvantage over U.S. producers in all lines of production. Another factor which provides some further protection for our manufacturers in the domestic market and an advantage for our exports to the U.S. market is the $7\frac{1}{2}$ per cent discount on the Canadian dollar in terms of American funds.

A recent study** by Greenshields Incorporated of the Kennedy Round results states that "the average Canadian tariff cut on manufactured goods is a modest 24 per cent and the average Canadian tariff level for manufactures remains comparatively high (15 per cent to 20 per cent). Duty reductions in some industries (e.g. machinery, chemicals and pulp and paper) are substantial." The

* See B. Balassa "Trade Liberalization Among Industrial Countries" (McGraw-Hill, 1967), for discussion of effective and nominal tariff rates.

**"Canada and the Kennedy Round", Greenshields Incorporated, August, 1967.

forthcoming reductions in tariff rates will vary for the many different kinds of forest products. The largest reductions will be 100 per cent - in the case of planed lumber where a ten per cent tariff will be eliminated - and 45 per cent with the reduction of the tariff on printing papers to a level of $12\frac{1}{2}$ per cent. Reductions of less than 25 per cent in the rates on wooden furniture and converted paper products will occur. The current tariff rates on many paper and wood products entering Canada will be reduced by something less than one-third (25 per cent to 33 per cent) by the end of the five-year implementation period.

The Greenshields' study also states that, "effective protection ... will have been reduced by less than the cuts in nominal rates would indicate because tariffs on machinery and chemicals, which are important components of the industry's production costs will be lowered by a similar or larger proportion than the industry's own tariffs." Specific tariff rates are given in the next chapter.

It is expected that some protected commodities from the forest-based industries could become relatively uneconomical to produce domestically at lower price levels and would instead be imported in future. The extent to which these adjustments in production will be necessary is uncertain at present. As the full tariff reduction will not come into effect for five years there should be adequate time for affected firms to divert production into their most favourable lines.

Some sectors of the forest-based industry have suggested that a drop in domestic prices, following tariff reductions, would cause a substantial loss of revenue to the Canadian producers and tax revenue to the governments. It is the manufacturers' view that despite the long-run opportunities for increasing exports as a result of other countries' tariff reductions, the Canadian industry must first make up any losses caused by increased imports before going on to expand exports.

The forthcoming reductions in Canadian and U.S. tariffs will eventually cause some significant structural changes in the protected segments of our industries. Specific opportunities and adjustments for the various industries within the forestry group cannot be predicted with any precision. The only concrete guidelines which are available are the existing trade patterns. These patterns for the fine paper industry and the veneer and plywood industry are reviewed in the second part of this report.

FINAL TARIFF RATES AGREED IN THE KENNEDY ROUND NEGOTIATIONS

Canadian Tariffs on Forest Products

Following full implementation of the new tariff rates Canada will still retain a relatively high level of tariff protection for most of the currently protected forest products.

OLD AND NEW TARIFFS FOR SELECTED FOREST PRODUCTS

	Present Rate (MFN)	Final Rate (MFN)
<u>Wood Manufactures</u>		
Logs and Rough Lumber	Free	Free
Lumber, Planed	10%	Free
Charcoal	4½%	4½%
Veneers	12½%	7½%
Floor Tiles	12½%	7½%
Plywood	20%	15%
Manufactures of Wood (n.o.p.)	20%	15%
Wooden Doors	22½%	15%
Furniture of Wood	25%	20%
<u>Pulp and Paper Products</u>		
Wood Chips	Free	Free
Paper Pulp	Free	Free
Newsprint	Free	Free
Printing Papers	22½%	12½%
Building Papers and Boards	20%	15%
Paper Sacks and Bags	20%	15%
Papers of all Kinds (n.o.p.)	20-22½%	15%
Wrapping Papers	22½%	15%
Envelopes and all Manufactures of Paper (n.o.p.)	22½-25%	17½%

U.S. Tariffs on Forest Products

Most of the important Canadian forest products have been included in the U.S. undertakings for either 50 per cent reductions or for duty eliminations. All Canadian lumber, both softwood and hardwood, will enter free of duty. Other products whose duties are to be eliminated include building board, building papers and some pulp board and paperboards. These commodities currently carry rates of duty of five per cent or less.

Manufactures of wood, including doors, prefabricated buildings, furniture parts, and building components, are currently dutiable at rates from 15% to 20%. The final tariff rates on these commodities will be at the $7\frac{1}{2}$ per cent to ten per cent level.

Tariffs on birch and maple veneers and birch plywood, products of considerable significance to Ontario producers, have been reduced by 50 per cent from eight per cent to four per cent and from 15 per cent to $7\frac{1}{2}$ per cent respectively*. Another reduction of potential significance to Ontario producers is wood particle board, the tariff on which has been reduced from 20 per cent to ten per cent.

The U.S. will make a 50 per cent reduction across the board on tariffs on paper and paper products. The most important trade item being reduced covers uncoated book and printing papers where tariffs will be cut from approximately 6.2 per cent to three per cent.** These papers are part of the fine papers and groundwood papers sectors within the pulp and paper industry. Canadian exports of these commodities to the U.S. were valued at \$20 million (U.S.) in 1966. The total worth of these paper imports was the highest of all dutiable papers imported from Canada. In 1965, more than one-third of all exports of book and printing papers originated from Ontario. A detailed analysis of the new trade potential for these papers is found in the second section of this report, "Trade in Fine Papers".

United Kingdom Tariffs on Forest Products

The bulk of Canadian exports, including forest products, currently enters Britain free of duty under the Commonwealth preference system. However, the reductions made by Britain on tariffs applied to exports of forest products from non-Commonwealth countries will serve to reduce the preferential position held by

* To the disappointment of western producers no reduction will be made in the 20 per cent tariff on softwood plywood.

**Newsprint and wood pulp already enter the U.S. free of duty.

Canadian goods. The Canadian advantage has already been severely reduced for forest products by the elimination in 1967 of tariffs against Britain's EFTA partners, including the Scandinavian countries.

Reductions in tariffs on paper products range between 15 and 20 per cent. Writing and printing paper tariffs have been cut from 16-2/3 per cent to ten per cent. Linerboard and kraft wrapping paper tariffs have been reduced to ten per cent from 12½ per cent and 13-1/3 per cent respectively. On forest products the reductions have included the elimination of all duty on rough softwood lumber, the reduction from 7½ per cent to five per cent of the tariff on dressed softwood lumber and the reduction from ten per cent to five per cent of the tariff on plywood.

EEC Tariffs on Forest Products

Tariffs on wood pulp will be reduced from six per cent to three per cent, with the present duty-free quota of 1.9 million metric tons remaining in force. Reductions in other tariffs were generally from one-quarter to one-third or less, with rates on kraft papers (linerboard), writing and reproduction paper, and building papers going from 16 per cent to 12 per cent. The corrugated container board tariff is reduced from 21 per cent to 14 per cent. The tariff on veneer is cut from eight per cent to seven per cent and that on plywood from 15 per cent to 13 per cent (hardwood) and from 14 per cent to 13 per cent (softwood). No reduction has been made on the newsprint tariff of seven per cent, to the disappointment of Canadian producers.

Japanese Tariffs on Forest Products

Only two tariff reductions are significant for Canadian forest industries. The tariff on newsprint paper is reduced from 7½ per cent to 5½ per cent, and the tariff on softwood plywood is cut from 20 per cent to 15 per cent.

Swedish Tariffs on Forest Products

The only relevant tariff reductions are on plywood and gummed paperboard where the rates have been cut from six per cent to three per cent.

Swiss Tariffs on Forest Products

The tariff rate on wood pulp has been reduced. However, other EFTA members already enjoy tariff free access to the Swiss market.

Other Canadian Tariff Rates

The following listing gives a selection of tariff rates covering broad import categories which include important products used by the forest-based industries.

	<u>Present Rate</u>	<u>Final Rate</u>
Iron, Steel and Wire Products		
Fourdrinier Wire Cloth	20%	17½%
Pipes for Papermaking	15%	unchanged
Machines		
Old (Class or Kind Made in Canada)	22½%	-
(Class or Kind Not Made in Canada)	7½%	-
New (Machines and Control Equipment)	-	15%
(Machines and Equipment Not Available from Canadian Sources)	-	full remission of duty
Veneer-Drying Machines	5%	free
Sawmill Machinery	12½%	unchanged
Lumbering Machinery	12½%	unchanged
Chemicals and Plastics		
New Basket Tariff Item for Chemicals	various*	not to exceed 15%
e.g. Chlorine	25%	
Caustic Soda	17½%	
Hydrochloric Acid	2½¢/lb.	

*Under previous Tariff Board rulings chemicals imported for use in the forest-products industries have entered duty-free.

	<u>Present Rate</u>	<u>Final Rate</u>
Chemicals and Plastics (Continued)		
Resins and Plastics	various	not to exceed
e.g. Urea Formaldehyde Resins	free	10% to 17%
Melomine Resins	free	7½%*
Epoxy Resins	10% to 17½%	10% *
Phenolic Resins	10% to 17½%	10% to 12½%*

*Part of proposed schedule of new tariffs recommended by the Tariff Board.

Other U.S. Tariff Rates

Most U.S. tariff rates covering industrial raw materials and production equipment will remain lower than the comparable Canadian rates.

	<u>Present Rate</u>	<u>Final Rate</u>
Machinery		
Most Machines and Parts for Making Pulp, Paper and Paperboard	7% to 10%	3½% to 5%
Exception: Bed-Plates, Roll-Bars and Other Stock Treating Equipment	13½%	unchanged
Woodworking Machinery	11½%	5½%
Chemicals		
Benzenoid Chemicals	Free to 100%	Free to 35%
Non-Benzenoid Chemicals	Free to 40%	Free to 20%
e.g. Chlorine	10½%	5%
Sodium Hydroxide	¼¢/lb.	1/10¢/lb. (conditional)
"Other" Inorganic Acids	12½%	6%
Resins and Glues		
Vinyl Resins	1½¢/lb. + 6¼%	6/10¢/lb. + 3%
Some Types of Animal Glues	½¢/lb. + 7½%	¼¢/lb. + 3½%

Other Tariff Rates

The final tariff rates quoted in this chapter have been taken from two sources; (1) "Canada Tariff Concessions Agreed in the Kennedy Round Negotiations", published in June 1967 by the Department of Finance, Ottawa, and (2) the July, 1967 issue of the journal "Foreign Trade", published by the Department of Trade and Commerce, Ottawa. The tariff rates for a great many other commodities are also listed in these two publications.

VI

FACTORS AFFECTING THE RESPONSE OF THE FOREST-BASED INDUSTRY TO NEW TRADE CONDITIONS

Capacity

The existing productive capacity of the forest-based industries in Canada is, in general, sufficient to support a considerable increase in exports. This year, up to the end of the third quarter, there has been increasing surplus capacity in the various sectors of the pulp and paper industry. Actual production as a percentage of productive capacity has been 91 per cent for paperboards, 88 per cent for newsprint, 88 per cent for other papers and 85 per cent for chemical pulps.* The excess capacity is the result of a current slowdown in growth of demand and a large increase in capital investment in the industry in the last five years.

Table 8

ANNUAL INVESTMENT IN THE FOREST-BASED INDUSTRIES, CANADA, 1960 TO 1967

Capital and Repair Expenditures (Millions of Dollars)

<u>Sector</u>	<u>1960</u>	<u>1963</u>	<u>1964</u>	<u>1965</u>	<u>1966</u> (pa)	<u>1967</u> (i)
Forestry	97	106	145	151	141	141
Wood Industries	87	94	110	132	115	100
Paper and Allied Industries	<u>267</u>	<u>326</u>	<u>454</u>	<u>565</u>	<u>719</u>	<u>617</u>
Total	451	526	709	848	975	858

(pa) preliminary actual
(i) intentions

Source: "Private and Public Investment in Canada, Outlook", Department of Trade and Commerce Annual.

*"The Pulp and Paper Industry" monthly statistical bulletin of the C.P.P.A.

Primary forestry activities showed a significant increase in annual investment and repair expenditures from 1963 to 1964, thereafter holding relatively constant up to the present. Annual expenditures in the wood industries showed a gain of 32 per cent from 1960 to 1966. As in the paper and allied industries' sector, intentions for 1967 suggest a contraction of new capital and repair expenditures in the wood industries.

The major increases in capital investments in the industry began in 1963. In that year, investment in capital and repair expenditures was more than ten per cent higher than the level of investments in 1962. Capital and repair expenditures continued to increase substantially each year up to 1966. Investment intentions for 1967, as determined in March of this year, indicate a decrease over the previous year's expenditures for the first time in this decade. Early indications suggest that 1968 expenditures will again continue downward as productive capacity has exceeded demand in the short run.

The outcome of the great increase in investment expenditures in the pulp and paper industry has been a comparable rise in productive capacity and actual production for most sectors of the industry. This data appears in Table 9. The basic capacity of the industry, in terms of annual capacity for wood-pulp production has increased 38.2 per cent from 1960 to 1967. The increase in capacity for book and writing papers was the highest among the sectors, 73.7 per cent from 1960 to 1966. Newsprint capacity exhibited the least increase, only 8.3 per cent from 1960 to 1966. It appears that little of the investment expenditures were for the purpose of increasing newsprint capacity. Wrapping paper capacity had increased by only 13.2 per cent from 1960 to 1966; however, a major increase in 1967 has raised capacity by more than 25 per cent in that one year alone. The international character of the Canadian pulp and paper industry has undoubtedly contributed to its spectacular growth in this decade.

Table 9

PULP AND PAPER: PRODUCTION, CAPACITY AND CONSUMPTION IN CANADA

<u>Commodity</u>	<u>Annual Production</u>		<u>Annual Capacity</u>		<u>Increase in Annual Capacity 1960 to 1966 %</u>	<u>Consumption Per Capita 1966 (lbs)</u>	<u>Increase in Consumption 1960 to 1966 %</u>
	<u>1966</u>	<u>1967* (thousands of tons)</u>	<u>1966</u>	<u>1967</u>			
Newsprint	8,419	8,123	8,878	9,336	16.6	65.8	23.9
Paperboard	1,674 ^e	1,560	1,662	1,715	43.0	147.2	25.6
Book and Writing Paper	587 ^e	717	745	763	73.7	46.7	33.8
Wrapping Paper	424 ^e	447	404	533	49.3 (1960-67)	39.2	19.5
Tissue and Sanitary Paper	202 ^e	260	255	265	58.4	21.9	32.7
Wood Pulp	16,004	15,504	17,108	18,158	30.2	-	-
Total Paper and Paperboard	-	-	-	-	-	359.5	24.0

e - estimate

*1967 production figures are based on production to September 30, 1967, as reported in the monthly statistics bulletin, Canadian Pulp and Paper Association.

Source: Reference Tables, July, 1967 - Canadian Pulp and Paper Association.

On the basis of current domestic per capita consumption, the Canadian market could dispose of only a portion of the maximum output which could be realized by the different sectors of the industry. The investment in productive capacity of the industry has been predicated on the continuing growth in world demand for papers and paper products. In order to take advantage of the projected growth of foreign markets, and to utilize the industry's excess capacity, emphasis must be placed on means to encourage exports.

Ownership

Variations in the degree of foreign ownership among Canadian industries will have a marked influence on the responses of the industries to changes in trade policy. The management of foreign-owned operations in Canada must be influenced by the economic situation of the parent operation as well as by conditions in Canada. In addition, when tariffs are reduced multilaterally, a U.S.-owned subsidiary operating in Canada might find itself in a position of competition with the products of its U.S. parent concern. The same situation will, of course, occur between Canadian-owned subsidiaries in the United States and a parent company in Canada. The response taken by the subsidiary - or imposed on it - is most significant to this study.*

The alternatives open to the parent firm range from closing the subsidiary, where production and distribution costs favour the parent operation, to integrating the subsidiary into a branch plant system. In the branch plant organization each establishment could specialize in the most profitable product lines for that establishment, or each could continue duplicating production, as before the reduction in tariff protection. The latter approach would be chosen

*For a detailed study of the operations of subsidiary companies in Canada, see "Foreign-Owned Subsidiaries in Canada", Department of Trade and Commerce, 1967.

by a company when there are insufficient economies of scale available to overcome regional production advantages related to marketing, transportation and distribution costs or other special considerations. The most likely alternative in many instances would appear to be some combination of specialization and regional production which makes use of the existing investment in subsidiary plant. Questions on such matters as plant location, rationalization and specialization of production lines will be analyzed differently by firms which are national in operation as opposed to those which are international, with establishments in several countries. A greater range of alternatives is available to the international firm.

In the forest-based industries in Canada there is a significant degree of foreign investment and control, particularly among the larger firms. By 1964, long-term investments in the wood and paper manufacturing industries valued at \$1,703 million* were owned by non-residents. Long-term investments by non-residents increased by \$158 million from 1963 to 1964 alone, and by \$388 million in the period from 1960 to 1964. The majority of these capital inputs have been in the form of direct investments in branches, subsidiaries and controlled companies. The biggest source of funds is, of course, the U.S.A.

More than forty per cent of the total investment in the Canadian pulp and paper industry is owned by U.S. interests. The degree of foreign ownership in the wood industries is considerably less than in the pulp and paper sector, although here too between 80 and 90 dollars of every \$100 of foreign-owned investment come from the U.S. In 1962, an estimated 20 to 25 per cent of the total assets of the wood industries was controlled by non-residents (on the basis of assets of corporations which are more than fifty per cent non-resident owned**).

* "Canadian Balance of International Payments, 1963, 1964 and 1965", Dominion Bureau of Statistics.

**See "Corporations and Labour Returns Act, Report for 1962", Department of Trade and Commerce, 1965.

Table 10

OWNERSHIP OF THE CANADIAN PULP AND PAPER
INDUSTRY*, 1963

	<u>Percentage Ownership of Total Investment</u>			
	<u>Canada</u>	<u>U.S.</u>	<u>U.K.</u>	<u>Other Countries</u>
Pulp and Paper Industry	48	44	7	1
All Manufacturing	46	44	8	2

*Canadian Balance of International Payments, 1963, 1964 and 1965, Dominion Bureau of Statistics.

In recent years there has been some additional influx of capital from other countries, including Scandinavia, several western European countries, Japan and even India. At the same time, Canadian firms have been seeking American, British and other foreign affiliations and subsidiaries, at least partly for the purposes of forward integration in production and marketing operations. Some of the recent acquisitions by Canadian firms are outlined in a later section.

Mr. R. M. Fowler, President of the Canadian Pulp and Paper Association, highlighted the international aspects of ownership and trade for the pulp and paper industry in an address presented in January, 1967:

"Investment in new and improved facilities has increased rapidly in recent years, and much of this by producers in other countries in partnership with Canadian firms. Increasingly, pulp and paper production is moving into the hands of large international companies. If we want rapid expansion of Canadian trade to meet rapidly rising world demands this is the way it will be done; ... growth based on Canadian efforts alone will be much slower. At the same time, Canadian companies will need to invest extensively in manufacturing and merchandising facilities in developed countries and in new industries in the less developed countries."(1)

(1) From an address by R. M. Fowler to the Annual Luncheon of the Canadian Pulp and Paper Association, January, 1967.

Structure

Historically, the protection afforded by our tariffs has supported the development of domestic producers with a structure suited to the limited Canadian market. As a result of such protection, our paper industry has developed a structure capable of supplying many grades, in short runs, to meet the needs of a small population. A similar situation exists in many other countries, each supporting their own domestic producers. Exports of protected grades of paper from Canadian producers have seldom accounted for more than one-tenth of total production. In contrast, 93 per cent of the tonnage of newsprint produced in Canada in 1965 was exported. Much of the volume of the protected grades which is exported has gone to other commonwealth countries where preferential arrangements provide low tariff barriers against the Canadian products.

In order to respond to the coming changes in trading patterns and lower tariffs, our forest-based industries will require restructuring and reorganization of their productive capacities. Emphasis will have to be put on greater specialization of production in those commodities in which our producers have the greatest competitive advantages. Within this country, rationalization can also be expected to include geographical concentration of production to take advantage of economies related to raw material supply, transportation, distribution and marketing advantages. Restructuring will require further capital investments in new or converted plants. Production facilities will have to be capable of achieving maximum economies through large-scale production in order to service the larger continental and international markets. In the pulp and paper industry this will mean the concentration of production in long-run, large volume, competitive grades of paper for domestic and foreign markets in order to achieve the maximum economies of scale. It is evident that the necessary rationalization of our forest-based

industries will require time, assistance and a degree of industry-wide planning and co-operation which is currently unknown and may even be illegal, under our combines laws.

When the structural changes needed for survival in an international market are viewed jointly with the existing ownership patterns in the forest-based industries some important observations can be made. Specialized production can be achieved somewhat more easily for internationally based or foreign owned operations than by wholly Canadian establishments.

Most international firms should be in a favourable position, with more numerous and varied operations, to alter their structures in terms of geographic and productive efficiencies to take advantage of continental or inter-continental market and production opportunities. Domestic firms, on the other hand, will become dependent on a reduced number of commodities in which they will specialize by virtue of their comparative advantages. Studies of the pulp and paper industry in Canada have suggested that freer trade with the U.S. will favour branch plant operations by the international firms, in contrast to wholly or partially owned subsidiary operations. The duplicate production functions of the subsidiary plant were more suited to the old tariff-protected, self-contained Canadian market.

Restructuring our forest-based industries will require more than a rationalization of production facilities alone. Further integration seems necessary throughout the industries to achieve the most effective and competitive distribution and marketing systems. Increased accessions by Canadian operations of organizations and outlets in United States and other foreign markets can be expected. An ownership interest in a foreign operation will help overcome institutional and non-tariff barriers to increased trade.

Activities aimed at forward integration and the purchasing of foreign

firms have been taking place in the Canadian pulp and paper industry. This year, a number of mergers and acquisitions have been effected by Canadian firms. Following the union of the Consolidated Paper and Bathurst Paper Companies, the new organization obtained control of two U.S.-based firms, a paper converter (Orchids Paper Products Company) and a manufacturer of tissues (Doeskin Products Ltd.). An interest has also been acquired in a British Columbia lumber wholesaling firm (Cooper-Widman Ltd.). The Abitibi Paper Company has announced the purchase of an eastern Canada fine paper distributor (Intercity Papers Ltd.). A French industrial combine (Cellulose du Pin of France) has acquired an interest in Donohue Bros. Ltd., a Quebec-based newsprint producer. This transatlantic connection has resulted in a contract for the annual sale of five to 10,000 tons of newsprint in the French market. MacMillan Bloedel Ltd. is planning to expand its logging activities in tropical areas. The company has acquired an interest in an enterprise which holds cutting rights to 100,000 acres on the island of Bougainville, east of New Guinea. In addition to these examples, there are said to be several companies actively seeking similar opportunities in Europe and the U.S.A.

Without greater international integration our independent, or non-U.S. affiliated, producers will face marketing handicaps such as lack of available outlets and distribution systems in America, and U.S. consumer ignorance about our "foreign" products, grades and specifications. The U.S. producers will not face the same degree of unfamiliarity because of the great overflow of U.S. advertising coverage into Canada. Canadian producers will have to make substantial investments in order to gain distributor acceptance for their trade marks and grades. Our firms will also have to provide the range of products and services expected by the consumers in the U.S. and other foreign markets.

The foreign marketing problems which will be faced by the Canadian

producers indicate that rationalization through mergers of the smaller firms into large, financially strong, integrated units is often appropriate. Another approach to the foreign marketing problem is the establishment of an export consortium.

Export Consortium

In 1960, an amendment to the Combines Investigation Act was instituted to protect companies which formed a consortium for export purposes from prosecution under the Act. The amendment requires that co-operation in the export market must be insulated from behaviour in the domestic market. A consortium acts as a common sales agency for all member companies. The advantages of a common export sales agency include lower costs of transportation and marketing through large-scale operations, better sales coverage and lower costs for the individual member. The consortium can offer the foreign buyer a wider range of products and larger quantities than would be available from a single company. Also, a consortium would often have a better credit standing for financing sales than would an individual firm. The greatest obstacle to the operation of a successful consortium lies in achieving co-operation and the mutually acceptable allocation of sales among competing member firms.

Two forest industry groups operating as export consortiums are Canexco and Seaboard Lumber Sales. Canexco is a Quebec-based group of twenty companies exporting softwood lumber and pulpwood to western Europe. Seaboard Lumber Sales, operating from British Columbia, represents a number of western lumber producers in European markets.

Anti-Dumping Restrictions

Current anti-dumping regulations ensure that producers in Canada and the United States will offer their products in the other country at prices not

lower than their own domestic market prices. In Canada, anti-dumping penalties have been applied if the price of an item is below its home market price. In the U.S., an imported good sold below its home market price must injure local manufacturers before anti-dumping penalties are applied. A new, less protective anti-dumping code similar to that of the United States has been accepted by Canada as a result of the Kennedy Round negotiations. The new code is to be in effect no later than July 1968.

Some Canadian pulp and paper manufacturers have contended that the U.S. anti-dumping regulations are a serious barrier to increased exports of papers to the U.S. - under current price differentials.* Although the actual application of American anti-dumping regulations to the protected paper grades has not been widespread, their effect has been to tend to discourage exports of Canadian papers and boards, apart altogether from the prevailing rate of duty. In order to compete in the U.S. markets, the prices of many exported papers will have to be lowered. Unless domestic prices are also reduced to the export price level, U.S. anti-dumping duties could then be imposed. A reduction in U.S. tariffs can be of no practical value to Canadian manufacturers with higher domestic prices, because of the anti-dumping prohibition on selling in the U.S. at American prices. On the other hand, the Canadian anti-dumping regulations do not exclude the less costly U.S. goods.

It seems very probable that some Canadian papers and paperboards now being sold in the U.S. are priced below our domestic prices. However, the volume of the protected paper and board exports to U.S. is quite small. While no complaints have been raised by U.S. producers, a large-scale expansion of this trade would run the risk of anti-dumping penalties.

*See also CEMA Report "Non-Tariff Barriers to Trade", April, 1967.

With the forthcoming reductions in our own protective tariffs, Canadian producers will be forced by import competition to lower their domestic prices to a level somewhat closer to U.S. market prices. The necessity for our producers to compete in the new continental market, coupled with the threat of anti-dumping penalties, will be a strong inducement toward the eventual establishment of parity prices in North America for many forest products.

Government Assistance to Industry

The Federal Government is expected by industry to provide some form of assistance to firms to adjust to new trading conditions. In January of 1966, the President of the C.P.P.A. stated that, in the event of major tariff reductions and exposure to U.S. competition: "the adoption of a policy of adjustment assistance is an essential first step to enlist active and understanding support for the reduction of trade barriers and to stimulate the industrial changes needed to compete actively in world markets".

The industry feels that the major requirement in an assistance program is flexibility so that the specific problems of each establishment may be dealt with effectively. The need for assistance and the type of assistance needed will vary from one mill to another, depending on size, type of production, opportunities within the company to engage in alternative types of production and the availability of alternative employment for workers in the area.

The system utilized by the EEC for the exposed industries of member countries provides assistance to those industries to help them re-establish in other lines or in different locations. The system includes cash compensation for the dislocation of factories and "trade adjustment allowances" for plants closed as a result of the internal tariff cuts among EEC members.

The details of assistance programs being planned by the Federal Government

are not yet available. It is known that trade officials are planning extensive consultations with industries and trade associations on anti-dumping legislation. Similar consultations have already been held in several cities to outline Canada's tariff concessions in the Kennedy Round and the new export opportunities available as a result of other countries' tariff reductions.

A model assistance program exists in the Auto Industry Adjustment Assistance Board. This Board was set up to help companies and workers affected by the auto pact. In order to encourage more efficient operations in the domestic auto parts industry the government has made provisions for loans at six per cent interest to help parts manufacturers expand production. Assistance is also available to workers whose jobs have been lost through adjustments in the auto industry as a result of the auto pact. Similar forms of transitional assistance encouraging adjustment and rationalization for the newly exposed industries such as paper converters could be instituted by the Federal Government.

Government spokesmen have suggested that capital, in the form of loans rather than grants, might be made available to companies whose business is seriously injured by the tariff reductions. An agency such as the Canadian Development Corporation could be used in a role similar to that of the Auto Industry Adjustment Assistance Board. The Corporation would act as a large-scale lending agency to provide assistance and incentives for rationalizing production. The government has also indicated that there will be more aid and emphasis on research and development to maintain and improve Canada's long-term trade prospects. The need for specific measures of assistance beyond the provision of a cheap source of capital is uncertain at this stage.

Disruptions to Canadian manufacturing firms, including the forest product manufacturers, will not occur suddenly, as tariff changes will be phased over some

years. The implementation of a new anti-dumping code for Canada will have more immediate impact on the manufacturing industries than the more gradual scheduling of tariff changes here and in other countries.

Various incentive schemes to encourage Canadian exports could be established by the Federal and Provincial Governments. Some forms of direct assistance, such as export subsidies to manufacturers, would be disallowed under GATT regulations. Other government activities, such as the provision of export credit services, export insurance and trade promotions, are acceptable under GATT. Credit, insurances, information and promotional services are already available to Canadian exporters. Tax relief, such as accelerated depreciation allowances and remission of sales and other "overhead" taxes on export goods,* is another area where export incentives can be provided. In the light of the Kennedy Round results, both the Government of Ontario and the Federal Government are currently putting emphasis on their established programs for trade promotion and export credit and insurance services. The expansion of these programs can be particularly useful to the forest-based industries with their export-oriented products.

*For an analysis of the effects of tax structures on international trade see "Border Tax Adjustments" in the O.E.C.D. Observer, No. 30, October 1967.

VII

SUMMARY AND CONCLUSIONS

Important changes in trading conditions are taking place in the major foreign markets for Canadian forest products. The most important factor affecting the British market has been the elimination in January 1967 of internal tariffs among the EFTA member countries. Canada's preferential trade position in the U.K. market has thus been effectively reduced. As a result, Canadian forest products exports are facing increased competition in Britain. In addition, Britain's current application for membership in the EEC would, if successful, probably result in the complete elimination of the Commonwealth preferential tariff rates now offered by the U.K. The common tariff rates of the EEC might then apply to Canadian exports of forest products to Britain.

The major western European exporters of paper and board products are Finland and Sweden. Both countries are members of the EFTA and are reported to be seeking membership in the EEC. Because of their lower transportation costs, forest products from Finland and Sweden have advantages over most North American commodities in the British and continental European markets. If the Nordic countries gain free access to the EEC market through membership in the Community, their export opportunities throughout Europe will only be limited by the eventual shortages of additional domestic timber supplies.

The greatest short-term expansion of demand for forest products is expected to occur in the European and Japanese markets. Britain and Germany are now the major European importers of paper and board products. Unfortunately, the tariff reductions offered by the EEC in the Kennedy Round, have not substantially opened up that market for many Canadian forest products. The tariff-free quota of 1.9 million metric tons has been retained by the EEC for wood pulp imports. The

newsprint tariff rate, applicable after a tariff-free quota of 625,000 metric tons has been reached, has not been reduced.

Although the actual enlargement of the EEC to include Britain, Sweden or Finland is unlikely in the near future, the Canadian Government must continue to work for greater trade opportunities with the Community. The potential market in the EEC for Canada's forest products is important both in itself and also as a counterbalance to our singular dependence on the U.S. market. For Canadian firms interested in improving their access to the EEC market, the vigorous development of affiliations with European companies would be valuable. The nationalistic outlook of France and the current European disfavour with the extent of U.S. acquisitions of European firms might provide the independent Canadian companies with an advantage over their U.S. competitors.

In the more immediate future, our industries will be influenced by the Kennedy Round tariff adjustments which will be implemented over the next five years by Canada and the U.S.A. Some sectors of the Canadian forest-based industries will be particularly affected by the changes. As a result of the tariff reductions, access to the U.S. market will be improved for a number of forest products. Improved export opportunities appear to exist for Canadian producers of book, printing and writing papers, hardwood veneers and plywoods, some building papers and boards, lumber and a number of lesser items. For Ontario, printing and writing papers and veneers and plywoods should offer the best opportunities.

Some increased U.S. competition in the Canadian home market may occur for wrapping, tissue and some grades of fine papers, paperboards, converted paper products, wooden furniture and some minor manufactured wood products. The remaining tariff levels on converted paper products and wooden furniture should still be sufficiently high to offer adequate protection to Canadian manufacturers. Many of the papers and

paperboards are relatively immune in the short run to import competition due to the integrated structure of the industries. As in the U.S., many of our converting operations are owned by the primary pulp and paper producers. In the longer term, the U.S. subsidiaries in Canada may achieve lower costs through rationalization of production between their U.S. and Canadian plants and greater exchange of commodities under the lower tariffs. The eventual result could be some pressure on our independent domestic producers' prices.

The opportunities and problem areas outlined above are very broad estimates, based on the consideration of specific tariff reductions, current trade deficits, raw material requirements and sources, quality of production facilities, and marketing characteristics. A more detailed analysis of the probable impact of Canadian and U.S. tariff adjustments for the printing and writing (fine) paper and hardwood veneer and plywood industries is presented in Part II of the report.

In summary, it appears that the general influence of the Canadian and U.S. tariff adjustments will be an overall increase in trade with the U.S. There may be a tendency toward parity prices in the new continental market for our previously protected forest products. Some slight lowering of the producers' domestic prices may occur due to increased U.S. competition and in order to take advantage of opportunities in the American market without fear of U.S. anti-dumping penalties. In addition, prices of manufacturing inputs such as production machinery should be somewhat lower as a result of tariff reductions on these commodities. There should be some further specialization by the forest products manufacturers in their most internationally competitive product lines, particularly for papers and other secondary manufacturing operations. In line with this specialization, outlets in the U.S.A. will be increasingly important for the Canadian forest products manufacturers.

Another important aspect of a move toward continental rationalization of production will be the response of U.S.-owned subsidiaries in Canada. A recent

Economic Council of Canada survey of the future investment plans of a sample of companies in Canada reports that:

"Particular uneasiness was expressed by a number of subsidiaries of foreign companies. Under lower Canadian tariffs, such foreign companies it was feared, might find it advantageous to build larger plants outside of Canada to supply the Canadian market as well as their home market, rather than to establish or expand manufacturing facilities in Canada."*

Because of significant advantages in Canada - the most important of which is the availability of non-exported raw materials - the exclusive development of sites outside Canada is not a serious possibility for the primary sectors of the forest-based industries. It is, nevertheless, a possibility which will have to be kept in mind for some of the secondary manufacturing establishments. The solution to this potential problem could become more important if the two countries move further toward bilateral free trade in forest products.

It appears that the Federal Government will next attempt to achieve the liberalization of trade in forest products and some other industrial sectors on a broad regional basis. A regional grouping which would be favoured by Canada for sectorial trade agreements would encompass the U.S.A., the EEC and EFTA countries, and any others who wished to join. General public opposition to a Canada-U.S. free trade area approach, and the serious problems related to industrial structure, ownership and market characteristics will probably delay for some years the development of a limited, bilateral forest products free trade agreement. Further specialization, rationalization and efficiency of production, which developments will be encouraged by the tariff reductions, must be achieved by the protected sectors of the forest-based industries before a limited bilateral agreement would be rewarding.

Apart from sectorial free trade for forest and mineral products throughout the world, some other policies for trade liberalization are also being advanced by Canada. With the final implementation of the new Kennedy Round tariff rates,

*As reported in the Toronto Globe and Mail, Dec. 5, 1967.

non-tariff barriers will be the most important obstacle to access to the markets of Canada's major trading partners. Success in effectively reducing these barriers on a world-wide scale is a long range objective due to the complex problems involved.

Another objective of the Federal Government is the expansion of trade between the developed and developing nations. World-wide free trade in tropical products has been proposed by Trade Minister Winters. If the proposal is accepted by other countries, it might in the future, produce some additional competition for our own forest-based industries. Extractive industries based on forest resources are a potentially important sector of the economy in many tropical countries. However, on economic grounds alone the merits of encouraging these developing markets out-weighs any minor negative aspects of the policy.

The government's future trade policies must continue to have as their objective "the balanced growth of the Canadian economy".* The objective can be achieved through the expansion of an efficient manufacturing sector, including the secondary industries. Growth can be assisted by a strong, competitive forest industry sector. Canada's trade policies, as they affect the forest products trade, must be bolstered by government encouragement to industry. There are a variety of forms of encouragement which can be offered by government. The degree and type of assistance to be offered to the forest-based industries as a result of the forthcoming tariff cuts is unknown. Export promotion and assistance programs are being emphasized by the Federal and Provincial Governments. Some capital funds may be made available through the provision of low cost loans to assist manufacturers to improve their efficiency of production. Revisions to the anti-combines legislation to promote rationalization and more efficiency in foreign marketing might be considered.

The manufacturers themselves will also have to put forth maximum effort

*See Address by Minister of Finance Mitchell Sharp to Annual General Meeting of the Canadian Manufacturers Association, Toronto, May 29, 1967.

to achieve efficiency of production, to successfully penetrate foreign markets and to face increased competition in their home market. A stronger marketing effort will be required in the U.S. and other countries. Greater joint undertakings, perhaps through export consortia, may also have to be undertaken within the various sectors of the forest-based industries.

The relatively long period and the gradual implementation of the new tariff rates will provide time for government and industry to recognize and plan the treatment of any emerging problems. In order to gain sufficient warning, close contact with the affected sectors of the forest-based industries will have to be maintained over the implementation period.

This report has been prepared in advance of the actual application of the new tariff rates and, in that sense, is a preliminary analysis. Continuation of studies of the effects of changing trade policies on the forest-based industries is very essential, as the consequences of the new tariffs and shifting trading patterns become clearer. The eventual adjustments and opportunities facing Ontario's forest-based industries will have a significant effect on the total economy and on the forestry oriented northern regions in particular.

APPENDIX I

MAJOR MULTINATIONAL TRADE ASSOCIATIONS

European Economic Community (EEC)

Belgium	Luxembourg
France	Netherlands
Italy	West Germany

European Free Trade Association (EFTA)

Austria	Portugal
Denmark	Sweden
Finland (Associate)	Switzerland
Norway	United Kingdom

Latin American Free Trade Association (LAFTA)

Argentina	Ecuador
Bolivia	Mexico
Brazil	Paraguay
Chile	Peru
Colombia	Uruguay
	Venezuela

Central American Common Market (CACM)

Costa Rica	Guatemala
El Salvador	Nicaragua
Honduras	

APPENDIX II

BACKGROUND INFORMATION ON GATT AND THE KENNEDY ROUND

GATT Principles

As was the case in previous multilateral negotiations in the postwar period, the Kennedy Round took place within the framework and under the aegis of the GATT. The GATT is a comprehensive, multilateral trade agreement embodying contractual rights and obligations and providing detailed rules and procedures for the conduct of commercial policy. The basic principles of the GATT may be summarized as follows:

1. Non-discrimination and most-favoured-nation treatment among all participants (with the exception of tariff preferences existing in 1947)
2. Prohibition of quantitative import restrictions, except in carefully specified circumstances
3. Consultation and co-operation for the avoidance of trade damage and for the expansion of trade.

Over sixty countries now participate in the work of the GATT. These include almost all of Canada's trading partners. Signatories to GATT account for more than 80 per cent of world trade. Canada, along with the United States, Britain, France and other major trading nations, was a founding member of the GATT. While the Soviet Union and certain other Eastern European countries are not members of GATT, Canada extends most-favoured-nation to these countries through separate trade agreements.

Previous GATT Negotiations

The Kennedy Round trade negotiations were significantly broader in scope and coverage than previous negotiations held under GATT. For the first

time they covered a variety of matters other than tariffs. For the first time also, they were based on the general adoption of across-the-board tariff cuts instead of item-by-item negotiations by most of the main participants.

Prior to the Kennedy Round there has been five major rounds of tariff negotiations held under GATT since 1947. These were: Geneva 1947, the first major postwar negotiation and the first time that tariff negotiations were conducted on a multilateral basis; Annecy 1949, Torquay 1951, Geneva 1956, and the "Dillon" round of tariff negotiations of 1960. Canada has been an active participant in each of these rounds of tariff negotiations, with its other major trading partners. The reduction of tariffs and other trade barriers is laid down in the GATT as one of the principal means of attaining its broad objectives. As a result of the successive tariff negotiations, the tariffs on tens of thousands of items entering into world commerce have, over the years, been reduced and bound against increase. The Kennedy Round thus represents the most recent and the most far-reaching of a series of moves in the liberalization of world trade and in the reduction of tariffs.

Source: "Foreign Trade", July, 1967, Department of Trade and Commerce, Ottawa.

APPENDIX III

COUNTRIES PARTICIPATING IN THE KENNEDY ROUND

The following forty-seven countries (including the six countries of the European Economic Community acting as one) were full participants in the GATT Kennedy Round negotiations.

Argentina	Malawi
Australia	New Zealand
Austria	Nicaragua
Brazil	Nigeria
Canada	Norway
Ceylon	Pakistan
Chile	Peru
Czechoslovakia	Poland
Denmark	Portugal
Dominican Republic	Sierra Leone
European Economic Community	South Africa
Finland	Spain
Greece	Sweden
Iceland	Switzerland
India	Trinidad and Tobago
Indonesia	Turkey
Ireland	United Arab Republic
Israel	United Kingdom
Jamaica	United States
Japan	Uruguay
Republic of Korea	Yugoslavia

Source: "Foreign Trade", July, 1967, Department of Trade and Commerce, Ottawa.

